

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Haynes Analyst: Jeff Garnier Bill Number: SB 114
Related Bills: See Legislative History Telephone: 845-5322 Introduced Date: 01/23/2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Alternative Minimum Tax/Deletes Appreciated Property Contributions as Tax Preference Items

SUMMARY

This bill would eliminate charitable contributions of certain property from the list of items that can result in the payment of alternative minimum tax.

PURPOSE OF THE BILL

The author's office indicates the purpose of the bill is to make state law the same as federal law as it relates to charitable gifts of certain property.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable years beginning on or after January 1, 2001.

POSITION

Pending.

Summary of Suggested Amendments

Technical or conforming amendments as described under TECHNICAL CONSIDERATIONS are needed.

ANALYSIS

FEDERAL/STATE LAW

Prior to 1993, federal law, for purposes of computing the alternative minimum tax (AMT), treated the deduction of charitable contributions of appreciated property as a tax preference item. The excess of the fair market value of the property over the taxpayer's adjusted basis at the time of the contribution was treated as an item of tax preference for AMT purposes during those years. The federal Revenue Reconciliation Act of 1993 eliminated contributions of appreciated property as a tax preference item.

Existing federal and state laws provide for AMT. AMT was established to ensure that no taxpayers with substantial economic income avoid all tax liability by using exclusions, deductions, and credits (tax preference items).

Board Position:

_____ S	_____ NA	_____ NP
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_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Gerald H. Goldberg

3/14/2001

Alternative minimum taxable income (AMTI) is computed by adding back to regular taxable income tax preference items and by making certain adjustments to taxable income. Tax preference and adjustment items are those tax benefits that have been identified as being instrumental in generating tax savings by reducing a taxpayer's taxable income. Examples of such items are standard and itemized deductions, accelerated cost recovery system depreciation, certain mining costs, depletion, and the deduction for charitable contributions of appreciated property. State law provides an AMT rate of 7% for taxpayers subject to the Personal Income Tax Law and an AMT rate of 6.64% for taxpayers subject to the Bank and Corporation Tax Law.

Under federal and state laws, in computing regular taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair market value of property contributed to a charitable organization, including certain appreciated property donated to a charitable organization. However, in the case of a charitable contribution of inventory or other ordinary income property or short-term capital gain property, the amount of the deduction is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, a taxpayer's deduction is limited to their adjusted basis in the property if the contributed property is not used by the donee for its tax-exempt purpose. For most contributions of appreciated property made by corporate taxpayers, the allowable charitable contribution deduction for regular tax is limited to the adjusted basis of the contributed property.

Under existing state and federal laws, donations of property may be treated as charitable contributions for purposes of the deduction if the property is contributed to or used by a qualified organization (public, private, or governmental), as follows:

- For corporations, the deduction for charitable contributions is limited to 10% of the taxpayer's net income (except as specified). Contributions in excess of 10% may be carried over to the following five succeeding taxable years.
- For individuals, the amount deductible for a contribution of property that has appreciated in value depends upon whether the property is ordinary income or capital gain property. Real estate typically is considered capital-gain property. For contributions to certain types of organizations, including governmental units, the maximum allowable deduction is limited to 50% of the taxpayer's adjusted gross income (AGI). In the case of appreciated capital-gain property, the deduction may be limited to 30% of the taxpayer's AGI.

Under federal law, contributions of appreciated property are not treated as tax preference items for purposes of AMT.

Under state law, for purposes of computing AMTI, the amount of any deduction (generally the fair market value for individuals) for charitable contributions of appreciated property (real, personal, or intangible) that exceeds the taxpayer's adjusted basis in the property is treated as a tax preference item and is added back to AMTI. In most cases, the AMT calculation for corporations is not impacted since the allowable charitable contribution deduction for regular tax is limited to the adjusted basis of the contributed property.

THIS BILL

This bill would conform California law to existing federal law by eliminating the deduction for contributions of appreciated property deduction as an item of tax preference. As a result, taxpayers no longer would need to include in their computation of AMTI the amount by which any allowable deduction for contributions of appreciated property exceeds the taxpayer's adjusted basis in the contributed property. Generally, this change would mean taxpayers may have a lower overall tax liability since it is less likely a taxpayer would become subject to AMT.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would occur during the department's normal annual update.

TECHNICAL CONSIDERATIONS

Due to the elimination of deductions of contributions of appreciated property as a preference item, references to this provision would no longer be necessary in the AMT credit provisions of the law. Sections 2 and 3 in Amendment 1 would eliminate the unnecessary references. Section 4 in Amendment 1 would eliminate a federal reference in the B&CTL relating to the charitable contributions of appreciated property.

LEGISLATIVE HISTORY

The following bills would have conformed to the federal treatment of contributions of appreciated property:

- AB 2073 (Battin) (1995-96) failed passage in Senate Revenue and Taxation Committee;
- SB 14 (Thompson) (1995-96) failed passage in Senate Appropriations;
- AB 265 (Battin) (1997-98) was held at the Assembly Desk;
- AB 2258 (Cardenas) (1997-98) failed passage in Assembly Appropriations;
- SB 1300 (Carderon) (1997-98) income tax provisions were amended out;
- AB 1208 (Assembly Revenue & Taxation Committee) (1999-2000) failed passage in Senate Appropriations Committee;
- SB 1760 (Speier) (1999-2000) failed passage in the Senate Appropriation Committee; and
- AB 2763 (Knox) (1999-2000) failed passage in Assembly Appropriations Committee.

OTHER STATES' INFORMATION

Only Alaska, California, Florida, Iowa, Maine, Minnesota, Nebraska, and New York impose an AMT comparable to the federal provisions. Iowa, Maine, Nebraska, and New York conform to the federal treatment of contributions of appreciated property. Minnesota conforms to the federal treatment of contributions of appreciated property except that 100% of a contribution made to an out-of-state charity (besides the federal government) is a tax preference item. Alaska and Florida do not have individual income taxes.

FISCAL IMPACT

This bill would not significantly impact the department's cost.

ECONOMIC IMPACT

Revenue losses are estimated as follows:

Fiscal Year Cash Flow Impact Effective 1/1/01 Enacted after June 30, 2001 (In Millions)			
	2001-02	2002-03	2003-04
AMT Charitable Contributions	(\$9)	(\$9)	(\$9)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

State tax return data for this specific preference item is not available.

Estimates for this bill are based on original federal projections in the Revenue Reconciliation Act of 1993, adjusted to take into account current trends in the fair market values associated with the types of assets subject to this proposal, namely stock and real property.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS SB 114
As Introduced January 23, 2001

AMENDMENT 1

On page 6, between lines 33 and 34 insert:

(Legislative Counsel please renumber the remaining bill section numbers)

SEC. 2. Section 17063 of the Revenue and Taxation Code is amended to read:

17063. (a) There shall be allowed as a credit against the net tax (as defined by Section 17039) for any taxable year an amount equal to the minimum tax credit for that taxable year.

(b) For purposes of subdivision (a), the minimum tax credit shall be determined in accordance with Section 53 of the Internal Revenue Code, except as otherwise provided in this part.

(c) For purposes of this chapter, the amount determined under Section 53(c)(1) of the Internal Revenue Code shall be the regular tax as defined by paragraph (2) of subdivision (b) of Section 17062, reduced by the sum of the credits allowable under this part, other than:

(1) The credits described in paragraph (6) of subdivision (a) of Section 17039.

(2) That portion of any credit which reduces the tax below the tentative minimum tax as provided in paragraph (1) of subdivision (c) of Section 17039.

(d) Section 53(d)(1)(B)(ii)(II) of the Internal Revenue Code, relating to credit not allowed for exclusion preferences, is modified to include subdivision ~~(f)~~(e) of Section 17062, as a specified item.

~~(e) Section 53(d)(1)(B)(ii)(II) of the Internal Revenue Code, relating to credit not allowed for exclusion preferences, is modified to include subdivision (e) of Section 17062, as a specified item.~~

SEC. 3. Section 23453 of the Revenue and Taxation Code is amended to read:

23453. (a) There shall be allowed as a credit against the regular tax (as defined by subdivision (c) of Section 23455), for any taxable year, an amount equal to the minimum tax credit for that taxable year.

(b) For purposes of subdivision (a), the minimum tax credit shall be determined in accordance with Section 53 of the Internal Revenue Code, except as otherwise provided in this part.

(c) For purposes of this chapter, the amount determined under Section 53(c)(1) of the Internal Revenue Code shall be the regular tax as defined by subdivision (c) of Section 23455, reduced by the sum of the credits allowable under this part other than that portion of any credit which reduces the tax below the tentative minimum tax as provided in paragraph (1) of subdivision (d) of Section 23036.

~~(d) Section 53(d)(1)(B)(ii)(II) of the Internal Revenue Code, relating to credit not allowed for exclusion preferences, is modified to include subdivision (b) of Section 23457, as a specified item.~~

SEC. 4. Section 23456 of the Revenue and Taxation Code is amended to read:

23456. For purposes of this part, Section 56 of the Internal Revenue Code is modified as follows:

(a) (1) Section 56(a)(2) of the Internal Revenue Code, relating to mining exploration and development costs, shall apply only to expenses incurred during income years beginning on or after January 1, 1988.

(2) Section 56(a)(5) of the Internal Revenue Code, relating to pollution control facilities, shall apply only to amounts allowable as a deduction under Section 24372.3.

(3) (A) Section 56(a)(6) of the Internal Revenue Code, as in effect on January 1, 1997, relating to installment sales of certain property, shall not apply to payments received in income years beginning on or after January 1, 1997, with respect to dispositions occurring in income years beginning after December 31, 1987.

(B) This paragraph shall not apply to any income year beginning on or after January 1, 1998.

(b) For purposes of applying Section 56(d) of the Internal Revenue Code, all references to "December 31, 1986," are modified to read "December 31, 1987," and all references to "January 1, 1987," are modified to read "January 1, 1988."

(c) Section 56(d)(1) of the Internal Revenue Code, relating to the alternative tax net operating loss deduction, is modified to include the provisions of Section 25108.

(d) For each income year beginning on or after January 1, 1988, and before January 1, 1990, Section 56(f)(2)(E) of the Internal Revenue Code, as it read during that period, is modified to refer to both of the following:

(1) Cooperatives under Section 24404 in lieu of the deduction allowed under Section 1382(b) of the Internal Revenue Code.

(2) Credit unions under Section 24405 as though the deduction allowed under Section 1382(b) of the Internal Revenue Code applied to credit unions.

(e) Section 56(g) of the Internal Revenue Code, relating to adjustments based on adjusted current earnings, is modified to provide that for corporations whose income is determined under Chapter 17 (commencing with Section 25101), adjusted current earnings shall be allocated and apportioned in the same manner as net income is allocated and apportioned for purposes of the regular tax. In addition, each of the following shall apply:

(1) Sections 56(g)(1)(A) and 56(g)(3) of the Internal Revenue Code are modified to provide that the term "adjusted current earnings" means the sum of the adjusted current earnings of that corporation apportionable to this state and the adjusted current earnings allocable to this state.

(2) Section 56(g)(1)(B) of the Internal Revenue Code is modified to provide that the term "alternative minimum taxable income" means the sum of the alternative minimum taxable income of that corporation apportionable to this state and the alternative minimum taxable income allocable to this state.

(f) Section 56(g)(4)(A) of the Internal Revenue Code is modified to provide the following:

(1) In the case of any property placed in service on or after January 1, 1981, and prior to January 1, 1987, other than residential rental property for which an election was made under former Section 24349.5, the amount allowable as depreciation or amortization with respect to that property shall be the same amount that would have been allowable for the income year had the taxpayer depreciated the property under the straight line method for each income year of the useful life (determined without regard to Section 24354.2) for which the taxpayer has held the property.

(2) In the case of any property placed in service on or after January 1, 1987, and prior to January 1, 1990, other than residential rental property for which an election was made under former Section 24349.5, the amount allowable as depreciation or amortization with respect to that property shall be determined by each of the following:

(A) Taking into account the adjusted basis of that property (as determined for purposes of computing alternative minimum taxable income) as of the close of the last income year beginning before January 1, 1990.

(B) Using the straight line method over the remainder of the recovery period applicable to that property under the alternative system of Section 168(g) of the Internal Revenue Code.

(3) The amendments made to paragraph (2) by the act adding this paragraph shall apply to income years beginning on or after January 1, 1990.

(4) The last sentence of Section 56(g)(4)(A)(i) of the Internal Revenue Code, shall not apply to income years beginning before January 1, 1998.

(g) (1) Section 56(g)(4)(C) of the Internal Revenue Code, relating to disallowance of items not deductible in computing earnings and profits, shall be modified as follows:

(A) (i) A deduction shall be allowed for amounts allowable as a deduction for purposes of the regular tax under Sections 24402, 24410, 24411, and 25106.

(ii) For each income year beginning on or after January 1, 1990, a deduction shall be allowed for amounts allowable as a deduction to a credit union for purposes of the regular tax under Section 24405.

(B) Section 56(g)(4)(C)(ii) of the Internal Revenue Code, relating to special rule for 100-percent dividends, shall not be applicable.

(C) Section 56(g)(4)(C)(iii) of the Internal Revenue Code, relating to special rule for dividends from Section 936 companies, shall not be applicable.

(D) Section 56(g)(4)(C)(iv) of the Internal Revenue Code, relating to special rule for certain dividends received by certain cooperatives, shall not be applicable.

(2) Section 56(g)(4)(D)(ii) of the Internal Revenue Code is modified to specify that Sections 24364 and 24407 shall not apply to expenditures paid or incurred in income years beginning on or after January 1, 1990.

(3) With respect to corporations which are not subject to the tax imposed under Chapter 2 (commencing with Section 23101), the amount of interest income included in the adjusted current earnings shall not exceed the amount of interest income included for purposes of the regular tax.

(4) Appropriate adjustments shall be made to limit deductions from adjusted current earnings for interest expense in accordance with the provisions of Sections 24344 and 24425.

~~(h) Section 56(g)(4)(I) of the Internal Revenue Code, relating to treatment of charitable contributions, shall not apply.~~